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Winston Hickox, Chair
CalEPA Market Advisory Committee
C/o California Environmental Protection Agency
1001 I Street
PO Box 2815
Sacramento, CA 95812

Re: Market Advisory Committee Comments

Dear Chair Hickox,

Thank you for the opportunity to comment on the "Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California", released on June 1, 2007 by the Market Advisory Committee.

Terra Global Capital provides organizations with strategic advice in environmental markets and is structured to act as a general partner for private environmental funds. Recently, we have expanded our business to address climate change in a much needed way by developing remote sensing based carbon measurement software for reforestation, aforestation, agro-forestry, changes in agricultural practices, and avoided deforestation projects. This technology will bring feasibility to many valuable projects, particularly those in areas of rural poverty.

We must commend the market advisory committee for making very insightful and practical recommendations for the design of California's system. It is clear that the Committee intended to formulate recommendations that will promote an efficient market for allowances and offsets, which is at the core of a properly functioning cap-and-trade system. We appreciate the opportunity to underscore some recommendations made by the Committee and advocate for changes in some areas. We offer the following recommendations for consideration in finalizing the final report provided to CalEPA and ARB:

Recommendations

- While the Global Warming Solutions Act calls for caps through 2020, it is clear that those caps will need to remain in place beyond 2020. Without certainty about the regulatory environment post 2020, market participants cannot make rational decisions regarding investments in technologies that may have long-term payback periods.

- As for the distribution of allowances, we underscore Cantor's June 12th detailed public comment that supports free allocation of allowances. We believe that an auction process will favor those companies with significant capital to support these purchases and disadvantage new or smaller companies that might be the very companies with the motivation and expertise to deliver GHG reducing technologies, better manage their resources, and develop projects that will generate credits. While free allocation puts an additional burden on regulators to determine the appropriate distribution mechanism, much of the data required to do this correctly does exist. Free distribution of allowances based on properly calibrated baselines does not create windfall profits, it only profits companies that through good management and technology are able to operate under their caps.

- It is very important to promote early action. For firms that will be regulated under caps, this can be achieved by excluding early action when establishing the baselines for free distribution of allowances. Early action should also include as broadly as possible credit for offset projects. It is imperative that clarity is provided on the types of project types that are recognized and that this list is as comprehensive as possible without jeopardizing environmental integrity.

- It is essential that a robust offset program is developed. There are significant environmental benefits to be gained by allowing offsets to be recognized and rewarded in the marketplace. While the Committee highlights all the initial concerns such as additionality and baselines that are raised when offsets are discussed, for many of these issues there are existing market practices under Kyoto's Clean Development Mechanism and the California Climate Action Registry that can be leveraged for the design of protocols.

- When it comes to the approach to protocols for offset projects, we believe that pure standards based approach will limit the potential for beneficial projects and support only those firms who have been included in the working groups used to develop of these protocols. This is particularly important in the early stages of market development when the market must support the on-going inclusion of all high quality projects and measurement technologies until enough is known to create a comprehensive and robust set of standards. Given the diverse project types and approaches to measurement, the Committee should recommend a structure that combines the adoption of high level protocols but allows for the on-going review and acceptance (with complete public access) of new methods. While this creates an on-going role for regulators to support, it is the only way to create a fluid market that accepts and rewards participants for innovation that meets environmental standards. In addition it makes public new methods and project types which will speed up innovation and adoption of new GHG reducing actions.

- We support the Commitee's recommendation that there should be no geographic restrictions to offsets and offer that this should include projects outside the U.S. given the global nature of GHGs. Further, we support the Committee's recommendation of no quantity limit on credits. However, we strongly disagree with the Committee's recommendation to discount offsets. The focus should be on developing and supporting standards and a process that address measurement concerns and not on discounting offset credits which will only lead to use of broadly based and potentially arbitrary discount factors that will distort the true value of the offsets.

- Banking credits is very important for entities to effectively manage their caps. As recommended by the Committee, this should be unlimited and we would add that it should be allowed across any phases or compliance periods that are developed. Without this, you could have a situation where credits for one vintage are trading pennies on the dollar versus another vintage, when both have delivered the same environmental benefit.

- We disagree with the recommendation that compliance periods will be set for every three years, while the reporting is on annual basis. We recommend that compliance and reporting periods be done on annual basis. If compliance periods are set longer than reporting periods, this sets too lax a standard for compliance, and distorts the signal to the marketplace regarding potential risks of non-compliance.

- Both the recommendations in the Committee's report and Governor Schwarzenegger's political actions, make it clear that California understands the benefits of linking its proposed cap-and-trade system to others both from the standpoint of supporting cost effective compliance, and promoting the development of other regulatory systems. We believe that the Committee has come up short on specifics of how this can be done. The balance of meeting the goals of environmental integrity, cost effectiveness, and fairness versus maximizing the linking opportunities to try and support a global GHG market should be done by approaching linking of allowances separate from offsets. Table 6-1 (p.67) of the draft report, outlines the "suitability" of linking some emission trading programs. The table combines the EU ETS with the Kyoto Clean Development Mechanism. These should be separate. The CDM should be separately outlined and it should be recommended that all projects that are approved under the CDM should be recognized under California's system. While not perfect, the CDM is the most comprehensive project market today and has done substantial work in developing a system to ensure the environmental integrity of project credits.

We appreciate the opportunity to comment on the Committee's recommendations and we urge you to consider our comments for issuance of your final report.

Respectfully,
(Transmitted via email)

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